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INTERNAL AUDIT DIVISION
OFFICE OF INTERNAL OVERSIGHT SERVICES

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19 November 2003

To: Mr J. P. Halbwachs, Controller
Department of Management

From: *for* Uwe Hain, Officer-in-Charge *William Petersen*
Internal Audit Division I, OIOS

Subject: **OIOS Audit Number AF2003/105/1: Follow-up Audit of the Iraq Escrow Account Treasury and Cash Management Functions**

1. I am pleased to present herewith the draft report on the above-mentioned audit, which was conducted during the period June to August 2003.
2. Please provide comments on the report's factual accuracy and recommendations and indicate action taken and a time schedule for the implementation of each accepted recommendation. Also please note that OIOS consider recommendations 1 to 3 and 5 to 10 as being of critical importance, and requests that you focus your attention on these recommendations.
3. We would appreciate receiving your reply by 15 December 2003.
4. I take this opportunity to thank the management and staff of the Treasury and other related offices, for the assistance and cooperation provided to the auditors in connection with this assignment.

Copy to:
Ms. S. Bishopric, Treasurer



United Nations
OFFICE OF INTERNAL OVERSIGHT SERVICES
Internal Audit Division

DRAFT
Audit Report

Audit subject: Iraq Escrow Account Treasury and Cash
Management Functions

Audit No.: AF2003/105/1

Report date: 19 November, 2003

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Audit of Iraq Escrow Account Treasury and Cash Management Functions (AF2003/105/1)

Executive Summary

OIOS conducted a follow-up audit of the Iraq escrow account treasury and cash management functions. The major objectives of the audit were to: (i) follow up on the implementation of previous audit recommendations; (ii) assess the status of the processing of oil and humanitarian letters of credit; (iii) assess the adequacy of the procedures to invest idle funds; and (iv) review the adequacy of contingency planning.

The administration of the Iraq escrow account is a unique and complex operation, requiring management of a large number of oil and humanitarian letters of credit, investment of large fund balances, establishment of complex banking arrangements, and balancing these factors in a sensitive political environment. Overall, the Treasury has done a creditable job in this environment. Despite the overall success of the operation, there were a number of issues which needed to be addressed as follows:

- ❑ Amounts held with the banks, as pointed out in OIOS' previous audit report (AF2001/34/1), continue to be above the maximum allowable limits as prescribed in the Treasury's internal policy document referred to as the Common Principles and Policies for Investments (CPPI).
- ❑ There were also inconsistencies between the bank rating requirements set out in the CPPI, which requires a minimum individual rating of B/C based on the Fitch Bank individual rating scale, and the banking agreements entered into which stipulated a rating of lower than C as one of the criteria for cancellation of the agreement with the bank.
- ❑ On 28 May 2002, the UN Treasury transferred \$1 billion from the Escrow account to the account in the name of the Central Bank of Iraq (CBI)/the Development Fund for Iraq (DFI) at the Federal Reserve Bank of New York as advised by the, Administrator, Coalition Provisional Authority (CPA). However the formal establishment of the Fund and its regulations came into force on 15 June 2003.
- ❑ Under Security Council Resolution 1483 which terminated the Oil-for-Food programme, 5 per cent of the proceeds from the sale of Iraqi oil are to be deposited into the UN Compensation Fund (UNCC). However, despite the fact that \$1.2 million had been transferred to the UN, no mechanism had been established to ascertain the accuracy of the amount received.
- ❑ The rental cost of office facilities in the Alcoa Building occupied by the Office of the Iraq Programme and the Treasury (Oil-for-Food Section) are \$1.5 million for the remainder of 2003 and \$3.4 million for 2004. There is no planned alternative use of the office space with the view to recouping some of the cost.
- ❑ Some of OIOS' audit recommendations, reported by the Treasury as having been implemented, were found to be still outstanding.
- ❑ There is need to conduct a "lessons learned" exercise in an effort to preserve institutional memory and also serve as a benchmark and model for similar complex treasury and financial management operations in the future.

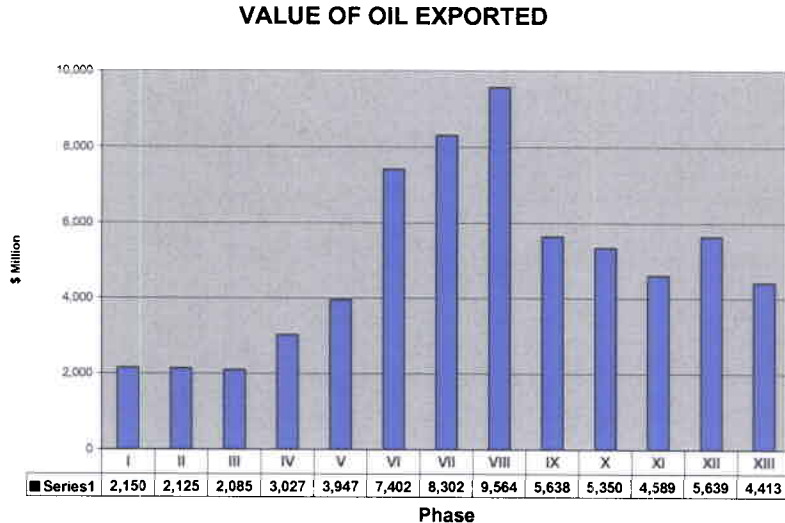
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I. INTRODUCTION

1. OIOS conducted a follow-up audit of the Iraq escrow account treasury and cash management functions. The audit was conducted in accordance with the standards for the professional practice of internal auditing in United Nations organizations.
2. The UN Treasury is responsible for overseeing the investment and use of the United Nations Escrow (Iraq) Account, which was established by Security Council Resolution 986 (1995) and subsequent resolutions which extended the Oil-for-Food programme (the Programme) on a 180-day cycle. A Memorandum of Understanding (MOU) signed in May 1996 between the UN and the Government of Iraq (GOI) further amplified the functions of the Oil-for-Food programme. The overall management and co-ordination of all United Nations humanitarian activities in Iraq is the responsibility of the Office of the Iraq Programme (OIP) that was established in October 1997.
3. Iraqi oil export proceeds were allocated as follows: (i) 59 per cent was earmarked for the ESB account (humanitarian supplies and equipment); (ii) 13 per cent for the ESC account (spare parts and equipment for northern Iraq); (iii) 25 per cent for a the UN Compensation Fund (UNCC); (iv) 2.2 per cent for the ESD account (UN administrative and operational costs); and (v) 0.8 per cent for the UN Monitoring, Verification and Inspection Commission.

Figure 1



4. At 31 March 2003, (Phases I to XIII) a total of 3,428 million barrels of oil with an estimated value of \$64 billion was exported (Figure 1), with the funds being allocated as per Paragraph 3 above.

but were partially resumed as mandated by SC Resolution 1472 of 28 March 2003 which gave a 45 day mandate, ending 12 May 2003 to, *inter alia*, prioritize deliveries and find alternative entry ports for shipment of supplies. The mandate was later extended, by Resolution 1476, to 3 June 2003 to allow for the delivery of existing contracts valued at \$665 million.

5. As a result of the conflict in Iraq, the activities of the programme were suspended on 17 March 2003,

6. Security Council Resolution 1483 (2003) (SCR 1483), dated 22 May 2003, requested that the Secretary-General, *inter alia*, in coordination with the Coalition Provisional Authority

(CPA), “continue the exercise of his responsibilities under Security Council resolution 1472 (2003) of 28 March 2003 and 1476 (2003) of 24 April 2003, for a period of six months following the adoption of this resolution, and terminate within this time period, in the most cost effective manner, the ongoing operations of the “Oil-for-Food” Programme (the Programme), both at headquarters level and in the field, transferring responsibility for the administration of any remaining activity under the Programme to the Authority, hence phasing out of the Programme over the next six months, ending 21 November 2003.”

II. AUDIT OBJECTIVES

7. The audit objectives were to: (i) follow up on the implementation of previous audit recommendations; (ii) assess the status of the processing of oil and humanitarian letters of credit; (iii) assess the adequacy of the procedures to invest idle funds; and (iv) review the adequacy of contingency planning to terminate the Programme.

III. AUDIT SCOPE & METHODOLOGY

8. The follow-up audit reviewed changes in the procedures for receipts and disbursements of funds for the payment of goods shipped to Iraq and funds transferred to other UN agencies. The audit also examined the management of surplus funds, agreements with financial institutions, and the impact of the implementation of previous audit recommendations, with the view to determining the overall efficiency and effectiveness of the management of the escrow account from its inception to date, covering relevant phases. The audit involved: (i) interviews with key officers involved in the financial management of the Escrow Account; (ii) reviewing and assessing relevant policy and procedures documentation to determine accountability; and (iii) observing and testing account transactions relating to letters of credit and investments.

9. The review of previous audit recommendations and their implementation was limited to those which were outstanding from the 2001 OIOS audit, some of which were deemed to be no longer relevant in light of current events. Also, given the imminent closure of the Programme by 21 November 2003, and the subsequent liquidation of all units by June 2004 as budgeted, the audit primarily focused on exit strategy and related planning measures.

IV. FINDINGS AND RECOMMENDATIONS

A. Letters of credit administration

Closure of letters of credit operations

10. SCR 1483 provided the CPA with specific measures to: (i) facilitate the shipment of goods under the approved and funded contracts; (ii) negotiate adjustments to the terms and conditions of these contracts and respective letters of credit; (iii) determine whether the contracts meet the needs of the Iraqi people during the transition; and (iv) fulfill all remaining obligations including settlement payments from the Escrow Account. In addition, SCR 1483 also stipulated that at the earliest possible time, unencumbered balances from the 2.2 per cent and 59 per cent accounts should be transferred to the Development Fund

for Iraq (DFI). To accomplish this task, the Treasury will have to make projections and provide adequate contingency reserves, bearing in mind that new contracts can also be entered into up until November 2003 pursuant to SCR 1472.

11. In order to meet the requirements of SCR 1483, the UN Treasury identified, as a key task, the reconciliation of all “approved and funded contracts” against all outstanding letters of credit for both the ESB and ESD accounts so as to determine the exact commitment to be paid from the Escrow Account. At the time of the audit, the Treasury had not yet made this determination.

12. At the time of the audit, the total obligation for the 3,591 outstanding letters of credit was estimated at \$10 billion, of which \$8 billion represents issued letters of credit and is therefore collateralized. There is no collateral for the remaining letters of credit valued at \$2 billion for which management indicated that funds had been segregated in IMIS. Since the reconciliation of contracts and letters of credit has not yet been completed, management indicated that the actual commitment against the Escrow Account was not expected to be determined before November 2003. Figure 2 sets out the expiration dates for the letters of credit.

Figure 2

**EXPIRATION OF LETTERS OF CREDIT (in millions)
as at 30 May 2003**

Currency	Up to 21/11/03	22/11/03 to 31/12/03	31/12/04	31/12/05	Beyond 31/12/06	Total
USD	641.0	144.5	196.1		1.3	982.9
EUR	4,254.9	434.1	900.0	30.1	34.4	5,653.5
CHF	382.2	24.0			189.6	595.8
GBP	66.5	1.0	1.5			69.0
SEK	1.6					1.6
JPY	16,135.6	1393.1	3171.6			20,700.3
Total (\$ billion)	4.8	1.7	1.3	0.1	0.1	8.0

13. The CPA is responsible for determining the relative utility of existing contracts to the needs of the Iraqi people, and prioritizing them accordingly. Under the action plan agreed to by the UN and the CPA, certain contracts will be allowed to expire as shown in Figure 3. This arrangement has implications for the role of the Treasury since funds for those contracts expiring after the closure of the Programme in November 2003 for which delivery has not been made, will have to be maintained in the Escrow Account unless other bilateral arrangements are made with the relevant parties.

14. Furthermore, the Treasury had not clearly outlined the course of action that will be taken regarding letters of credit and supporting contracts for which delivery will go beyond 21 November 2003. Since the letters of credit are irrevocable, unless clear arrangements are made for transferability to the Authority at the end of the Programme, the UN will have to continue to act as administrator of the Escrow Account.

Figure 3

ACTION PLAN FOR CONTRACT EXPIRATION

1. Contracts assigned utility and priority, which have L/C's issued and outstanding	Extended through 21 November 2003, according to the amended agreement between the UN agency concerned and the supplier and based on the shipment dates of the goods
2. Expired L/Cs for contracts assigned utility and priority	To be reinstated in accordance with the amended agreement
3. Contracts with relative utility and priority, which have no L/C's issued and outstanding,	New L/Cs will be issued by the UN
4. Contracts with "questionable utility" that have outstanding L/Cs	Will eventually expire in accordance with previously agreed terms ¹ . The UN will allow such expiring L/C to lapse. These contracts would be held in abeyance until an internationally recognized government of Iraq is in a position to make its own determination
5. Contracts with no L/C and that have "no utility"	No action will be taken by the United Nations.

15. In OIOS' opinion, the planned reconciliation of contracts against letters of credit should be expedited so as to determine the current status of the commitment to be met from the Escrow account as quickly as possible.

Recommendations 1 and 2

The UN Treasury should:

- (i) Address outstanding issues relating to the administration of letters of credit, including but not limited to the documentation of a clear action plan for the administration of the letters of credit and supporting contracts for which delivery will be made after the close of the Oil-for-Food programme and the implications for the continued management of the Escrow Account (AF2003/105/1/001); and
- (ii) Expedite the reconciliation of the letters of credit and the contracts in order to determine the current obligations to be met from the Escrow Account (AF2003/105/1/002).

Authentication of delivery of goods to Iraq

16. Humanitarian letters of credit are subject to authentication procedures on arrival in Iraq of the goods supported thereby, by an independent customs inspection agent, the UN Treasury and Banque Nationale de Paris - Paribas (BNP), before payment can be made. Management indicated that negotiations are currently in progress between the CPA and OIP concerning the authentication procedures if the current contracts are not extended beyond November 2003.

¹ Each L/C is fully cash collateralized with funds required to remain in the Escrow Account until the liability is extinguished. Therefore, the collateral for L/Cs outstanding as of 21 November 2003 and beyond will be kept in the Escrow Account and will be managed by the Treasury until the payments are effected or the relevant L/C has expired.

Such arrangements should be clearly determined given the implications for finalizing payments under the letters of credit supporting goods which are delivered after November 2003. OIOS is of the view that the related action should be documented as part of the comprehensive exit strategy.

Recommendation 3

The UN Treasury should, in collaboration with the Office of the Iraq Programme, follow-up on the arrangements being made by the Coalition Provisional Authority to have letters of credit and the receipt of goods supported thereby authenticated after November 2003 (AF2003/105/1/003).

Lessons learned

17. The UN Treasury is responsible for fund management and the investment of the proceeds of Iraqi oil revenues deposited in the Escrow Account, and has played a vital role in ensuring orderly payment for goods and services procured by the GOI under the Programme. In this regard, it would be beneficial for the Treasury to conduct a “lessons learned” exercise which would preserve institutional memory and serve as a benchmark and model for similar programmes in the future. This exercise should be carried out as part of a comprehensive lessons learned exercise of the UN’s experience with managing the Oil-for-Food programme and its related activities.

Recommendation 4

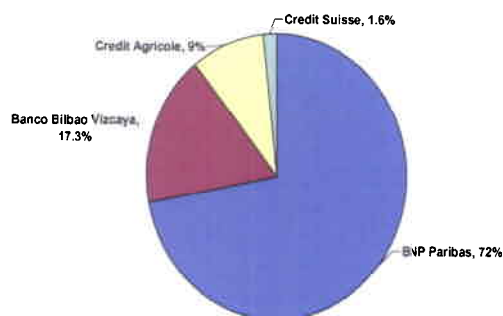
The UN Treasury should initiate a “lesson learned” exercise concerning its responsibilities for the administration of the Escrow Account, particularly with regard to the administration of letters of credit, which should become part of an Organization wide lessons learned exercise and serve as an UN-wide model for similar projects in the future (AF2003/105/1/004).

B. Investment management

Existing policy needs to be updated and excessive exposure monitored

18. As noted in OIOS’ previous audit report dated 22 August 2002, the Treasury’s Common Principles and Policies for investments (CPPI), approved in January 2000, continued to be used as the guidelines for the investment of funds relating to the Programme. However, these guidelines were not updated as recommended to specifically address investment issues relating to the Programme. As also stated, amounts held with the banks continue to be above the maximum allowable limits as prescribed in the CPPI.

Figure 4: INVESTMENT BY BANK AT 13 JUNE 2003



19. Funds are currently invested in four (4) banks, down from six (6) in 2001 as follows: BNP Paribas (BNP), Banco Bilbao Vizcaya (BBV), Credit Agricole (CAI) and Credit Suisse (CS). An analysis of investments by bank as at 13 June 2003 (Figure 4) showed that the funds placed with BNP represented 72 per cent. In OIOS' view, this continues to represent an unacceptable level of risk which must be monitored, particularly in light of the abandonment of the plans for further diversification pursuant to the pending closure of the Programme. There is

therefore a need to analyse the solvency of these banks to determine their ability to meet any immediate liquidation of funds placed with them.

Recommendation 5

The UN Treasury should monitor, through liquidity analyses, the banks with which large holdings are invested, to ensure that their respective liquidity capacities do not expose the Escrow Account to undue risk (AF2003/105/1/005).

Inconsistency between banking agreement and the CPPI

20. Subsequent to OIOS' 2001 audit, the Treasury removed two banks from its approved list: Hypo Vereinsbank and Deutsche Bank, because they were downgraded from B/C to C, which was in accordance with the CPPI which states that "...a minimum individual rating of B/C by Fitch IBCA or equivalent must be maintained" by banks on the approved list. However, the respective bank agreements stated: "the UN may terminate this agreement forthwith upon ... downgrading of the Bank's individual credit rating by IBCA to lower than C." Therefore, the audit concluded that the removal of these banks from the approved list contradicted the provision in the banking agreements.

Recommendation 6

The UN Treasury should ensure that all banking agreements entered into are consistent with internal policies concerning bank ratings and maximum fund balances to be held in any one bank (AF2003/105/1/006).

C. Other actions taken to implement SCR 1483

21. SCR 1483, paragraph 12 noted the establishment of the DFI to be held by the Central Bank of Iraq (CBI) ..., and requested, in paragraph 17, the transfer of \$1 billion to this fund from unencumbered funds in the Escrow account, "as soon as possible". The Treasury made this transfer on 28 May 2003, to an account in the name of the DFI and the CBI at the Federal Reserve Bank of New York as instructed by the CPA. Although the necessary due diligence was carried out by the UN Treasury to ensure that the funds were credited to an account in that name, it did not validate the official establishment of the Fund. OIOS concluded that this transfer was done before the DFI was formally established and its governing regulation called the CPA Regulation Number 2, signed off on, effective 15 June 2003. Section 3 of this Regulation, entitled "Establishment of the Fund" stipulated that the Fund shall be on the books of the CBI and the corpus of the Fund shall be held in an account entitled "CBI/DFI" in the Federal Reserve Bank ... for the CBI. Section 5, paragraph 3, acknowledged and confirmed the transfer of the funds.

22. Furthermore, SCR 1483 stated that five per cent of the proceeds of Iraqi oil sales would be allocated to UNCC. However, no mechanism had been established to ascertain the accuracy of the amount received (\$1.2M to date) with respect to the five per cent allocation. The audit determined that there is a need to establish appropriate procedures to adequately monitor the amount of funds deposited into the UNCC.

23. The rental cost of office facilities in the Alcoa Building occupied by the OIP and the Treasury (Oil-for-Food Section) is \$1.5 million for the remainder of 2003, and \$3.4 million for 2004, when the lease arrangement ends. The UN Treasury proposes to meet the building costs as follows: in 2003, 75 per cent will be paid from the ESD account and 25 per cent from United Nations Monitoring, Verification and Inspection Commission (UNMOVIC), while in 2004, UNMOVIC will fund 66.67 per cent and ESD 33.33 per cent, since the Programme and related activities would have already been liquidated, resulting in vacant office space. The activities of UNMOVIC have been allowed to continue until such time that the Security Council revisits its mandate, according to SCR 1483. However, there is no planned alternative use of the office space with a view to recouping some of the cost.

24. A sub-fund, called "the special account for reimbursement of services provided by Headquarters to UNCC and UNMOVIC" was established on 22 July 2003, as approved by the UN Controller. The account calls for a one per cent, surcharge (\$900,000) to be levied on UNCC's and UNMOVIC's currently approved budgets to cover administrative expenses. The Office of Programme Budget and Accounts (OPPBA) estimated \$780,000 for annual salary costs for these two activities and used it as the basis for prorating the allocation of \$390,000, which represent half of the annual salary cost to cover for the six months period up to December 2003. On this basis, UNCC would be charged 60 per cent and UNMOVIC 40 per cent of the total salary costs. However, the audit found that the details of the specific services to be funded from this "special account" and the basis for establishing it had not been documented.

Recommendations 7 to 9

The UN Treasury should:

- (i) Ensure that in the future, fund transfers are made only to entities that have been officially established (AF2003/105/1/007);
- (ii) Establish a mechanism for verifying the correctness of receipts relating to the transfer of five per cent of oil revenues by the Coalition Provisional Authority to the UNCC, including arrangements regarding the modalities to achieve this (AF2003/105/1/008);
- (iii) Pursue alternative options for utilization of the office space in the Alcoa building which will become vacant after cessation of the major activities of the Office of the Iraq Programme and the Oil-for-Food Section of the Treasury with the view to minimizing costs to the Programme, until the end of the current lease in 2004 (AF2003/105/1/009); and

OPPBA should, with regards to the establishment of the “the special account for reimbursement of services provided by Headquarters to UNCC and UNMOVIC”, ensure that the basis for this sub-fund and the appropriate governing regulations are formalized and documented (AF2003/105/1/010); and

D. Exit strategy, liquidation and contingency planning

25. SCR 1483 stipulates that a comprehensive strategy be provided to the Security Council by 24 October 2003, on the delivery of all relevant documentation and the transfer of all operational responsibility to the CPA. In this regard, OIOS recognized that the UN Treasury had done a substantial amount of preliminary work including the preparation of a timeline and a drawdown schedule of tasks to be carried out, as well as a liquidation budget and letters of credit administration plan. At the time the audit was concluded, the planned strategy had not yet been fully documented, and integrated into the comprehensive exit strategy.

Formulation of operating budget

26. Paragraph 16(c) of SCR 1483 requested that an estimated operating budget be presented to the Security Council “for review and consideration” by the 12 June 2003. OIOS’ review found that the procedure for the preparation, review and approval of the liquidation budget varied from the prevailing budget procedure followed by OIP/OPPBA and was not documented.

27. Unlike the other activities which submitted budget proposals, no written budget

submissions were made by Office of Legal Affairs (OLA), OIOS, Department of Management (DM) and Department of Peacekeeping Operations (DPKO); these offices provide services such as legal and internal audit for the Programme. Except for DPKO, with a budgeted completion time of March 2004, OPPBA projected their operations to cease effective 21 November 2003, despite the planned continuation of OIP and UNOCHI up to March and June 2004 respectively. Management indicated that, for example, any legal and audit services subsequent to 21 November 2003 could be met from existing capacities in OLA and provision made for the External Auditors to audit the financial statements at the end of the liquidation of the Programme. There was no recognized need for internal audit services from OIOS after that date.

28. OIOS also observed the following:

- i. The budget document, as approved by the UN Controller, showed only estimated amounts, totaling \$106.6 million, and did not include a comprehensive formal budget document with an overview, explicitly stated assumptions, justifications etc., though these could be deduced from the Secretary General's (SG) report, which management indicated was presented at an informal session of the Security Council.
- ii. Budget submissions were inconsistent. Also, changes were made by OPPBA and the final version was communicated to the agencies/programmes directly by the UN Controller, and not by OIP through which agency submissions and communication were normally channeled;
- iii. The budget details showed that most of the staff evacuated from Iraq was budgeted as being back in Iraq by July 2003. However, the status could not be verified in IMIS;
- iv. As part of the present budget practice, the appropriate allotments for HQ units, especially for OIP and United Nations Office of the Humanitarian Coordinator for Iraq (UNOCHI), had not yet been made to ensure the effective monitoring by OPPBA of line items relating to the new budget; and
- v. There is a need to determine as early as possible the adequacy of the contingency reserves associated with the respective accounts before balances are transferred to the CPA. Fifteen per cent of the total estimated costs was envisaged as a contingency for the operating budget, and the balance was to be transferred to the DFI, as per Secretary General's report dated 11 June 2003. However, this stipulation did not form part of the budget document.

Recommendations 10 to 12

OPPBA should:

- (i) Formally document the liquidation budget procedure, clearly indicating deviations from the prevailing budget procedures (AF2003/105/1/011);

- (ii) Actively follow-up with the Office of Iraq Programme and United Nations Office of the Humanitarian Coordinator for Iraq to complete the appropriation of allotments (AF2003/105/1/012); and
- (iii) Establish adequate contingency reserves for all escrow accounts (AF2003/105/1/013).

E. Follow-up on previous audit recommendations

Not all audit recommendations had been implemented as stated by the UN Treasury

29. Prior audit recommendations (Annex) were not always implemented as indicated in the Treasury's response to OIOS. For example: (i) the CPPI had not been updated as stated by the Treasury; (ii) an investment committee was not established; (iii) policy issues such as the holding of long-term callable CDs were not be addressed; and (iv) the joint team to review the OPICS/IMIS interface had not been formed as stated. Regarding the IMIS/OPICS interface, OIOS noted that some progress was made during the course of the audit, and that the project has gathered momentum in light of the introduction of SWIFT for more effective electronic funds transfer. The project is being managed by the Accounts Division. However, there is need for the Treasury to formalize the adhoc committee to liaise with the Accounts Division.

Recommendations 13 to 15

The UN Treasury should:

- (i) In the future, ensure that it provides OIOS with accurate and up-to-date information on the status of implementation of audit recommendations (AF2003/105/1/014);
- (ii) Appoint a focal point to monitor and follow-up on the implementation of audit recommendations (AF2003/105/1/015); and
- (iii) Given the relevance of the IMIS/OPICS interface to other treasury functions, actively follow-up with the Accounts Division to ensure timely implementation of the interface (AF2003/105/1/016).

F. Bank Reconciliation

30. The general ledger (G/L) showed escrow account balances of \$17.9 billion and €71.8 billion for the ESB account and \$2.1 billion for the ESD account as at 31 March 2003. Sound financial management practices dictate that bank reconciliations should be prepared accurately, timely reviewed and properly monitored in order to ensure that the financial status of the funds is

correctly reflected. The audit found that, in general, the Escrow Account bank reconciliations were in order, with the following exceptions: (i) there was no formal documentation on internal procedures to address issues such as long outstanding items; (ii) no benchmark had been established for processing time; (iii) there were several items which took three to six months to clear; and (iv) there were several versions of bank reconciliations that were in draft only, and a few cases where the final versions lacked the signature of supervisors.

31. There is also a need for cross-training of, and sharing of best practices among staff, especially those affected by reassignment and rotation in order to minimize the increasing number of items to be reconciled as a result of errors and omissions such as charges to incorrect accounts and discrepancies between the OPICS and bank statements. During the course of the audit, OIOS documented a procedure for this process for consideration by the Accounts Division.

Recommendations 16 to 18

In order to strengthen internal controls over bank reconciliation, the Accounts Division should:

- (i) Formally document and distribute the internal procedures for bank reconciliation, indicating the standard time frame for preparation, approval and follow-up of outstanding items and defining terms and/or codes for its uniform application (AF2003/105/1/017);
- (ii) Regularize the final bank reconciliation records by obtaining the signatures of reviewing supervisors to complete the files (AF2003/105/1/018); and
- (iii) Cross-train staff in order to facilitate the bank reconciliation review of standard working papers, such as comparative spreadsheets on bank and OPICS prepared by the staff (AF2003/105/1/019).

V. ACKNOWLEDGEMENT

32. We wish to express our appreciation for the assistance and cooperation extended to the auditors by the Treasury, the Accounts Division and the Office of Iraq Programme.

Uwe Hain
Officer-in-Charge
Internal Audit Division I, OIOS

SUMMARY OF AUDIT RECOMMENDATIONS

(AF2001/34/1)

As at 30 April 2003

Recommendation	Treasury's Response
<p>Policies & Procedures</p> <p>Make appropriate amendments to the CPPI to address areas where the current regulations are not applicable to the Iraq Account (AF2001/34/1/01);</p>	<p>(as at 31 March 2002)</p> <p>Treasury had made appropriate amendments to CPPI in order to address the areas where the current regulations are not applicable to the Escrow Account.</p> <p>Status: Closed</p> <p>OIOS comment: The CPPI was not revised and submitted to OIOS. However, in light of the closure of the Programme, the status in our recommendation database will not be changed.</p>
<p>Establish an investment committee to oversee the investment of Iraq escrow account funds, comprising <i>inter alia</i>, representatives of OIP, Treasury, and the GOI, if deemed appropriate (AF2001/34/1/02),</p>	<p>(as at 31 July 2002)</p> <p>An Investment Committee has been constituted and has met to discuss the additional banks. As banking arrangements require substantive knowledge, until the GOI posts a banking representative as envisaged in the MOU, GOI participation would be fruitless.</p> <p>Status: Closed</p> <p>OIOS comment: The request for the Client to provide OIOS with the composition and terms of reference of the committee for review was not met and the committee was not formally constituted as indicated. However, in light of the closure of the Programme, the status in our recommendation database will not be changed.</p>
<p>Engage a consultant with expertise in financial risk mitigation techniques to review the overall management of the Escrow Account in order to advise on appropriate procedures that need to be established to manage the account (AF2001/34/1/03).</p>	<p>(as at 31 March 2002)</p> <p>Treasury sees no merit in this recommendation.</p> <p>Status: Withdrawn</p>
<p>Letters of Credit</p> <p>Establish a written policy for issuing humanitarian L/C's and achieving diversification among banks, which identifies the basis for allocating L/C's among the various banks, and the maximum value of L/C's to be issued by individual banks (AF2001/34/1/04);</p>	<p>(as at 31 July 2002)</p> <p>Humanitarian L/C's are issued in accordance with the MOU and the relevant Security Council Resolutions. The value of L/C's cannot be determined precisely in advance, however, a plan to diversify L/C's according to sector has been drafted.</p> <p>Status: Closed</p> <p>OIOS comment: Planned diversification abandoned after the passing of SCR 1483, and therefore no longer relevant.</p>

<p>(Letters of Credit Cont'd)</p> <p>Examine (before finalizing the current L/C diversification exercise) additional ways of diversifying L/C's among a greater number of banks with acceptable credit ratings in order to reduce risks and to increase competitiveness that may result in lower L/C fees (AF2001/34/1/05)</p>	<p>(as at 2 October 2002)</p> <p>Further diversification of banking arrangements at this time would set back the current diversification process for letters of credit. Treasury intends to first implement the current diversification programme successfully before repeating the exercise. Diversification will take time because humanitarian L/C's must be fully collateralised with deposits and can only be funded with oil revenues received after February 2002 when diversification issues are resolved. Further, RFP's must be issued and this is a very time-consuming process.</p> <p>Status: Closed in 2003</p> <p>OIOS comment: Planned diversification abandoned after the passing of SCR 1483, and therefore no longer relevant.</p>
<p>Determine if additional staffing is needed to handle the anticipated workload increase as a result of diversifying the issuance humanitarian L/C's and investments (AF2001/34/1/06).</p>	<p>(as of 31 March 2002)</p> <p>Treasury will follow up on the implementation of this recommendation with the implementation of the diversification of the banking services for the Escrow Account. Additional requirements will be formally presented to senior management of the UN by the end of June 2002.</p> <p>Status: Closed at the time of final report</p> <p>OIOS comments: Client can update OIOS of developments in this area, particularly, in the light of the diversification and the implications for staffing.</p>
<p>Diversification of Investment:</p> <p>Develop a plan to further diversify the escrow account investment portfolio by placing funds with institutions which have high credit ratings and that a list of these institutions is provided to the GOI for its review. In deciding how to diversify funds, primary consideration should be given to achieving acceptable risk levels that comply with the established investment policies of the Organization (AF2001/34/1/07)</p>	<p>(as at 2 October 2002)</p> <p>The monies of the Escrow Account are currently deposited with four (4) banks and Treasury is able to diversify the investment of only those funds that are not required as collateral for L/C's. Furthermore, Treasury believes that the Investment Committee of the UN Iraq Escrow Account should take the initiative on this issue. Mr. Joseph E. Connor was provided with a list of suitable candidates awaiting his approval so that the Committee can be formed and begin its work. The Treasury believes recommendation #s 5 & 7 are related and that their implementation is a process, not an event.</p> <p>Status: Closed in 2003</p> <p>OIOS comment: Planned diversification abandoned after the passing of SCR 1483, and therefore no longer relevant.</p>
<p>Investment maturities:</p> <p>Review the implications of its strategy to invest escrow account funds in callable CDs with maturities in excess of one year, considering the short-term nature of the Oil for Food Programme, and the risk of losing principal should an investment need to be liquidated before the</p>	<p>(as at 2 October 2002)</p> <p>Treasury must assert that in the case of callable CDs there is a zero risk of losing principal regardless of whether they are called or cashed-in early. Furthermore, OIOS has chosen to ignore Treasury's assertion that the Escrow Account had adequate liquidity at the time the audit was conducted, and that the terms of said investments fully met the requirements of the CPPI. Treasury believes this recommendation has no merit.</p> <p>Status: Closed in 2003 Audit</p>

maturity date (AF2001/34/1/08)	OIOS comment: A review of the investment portfolio shows that this type of investment no longer exists.
Integration of OPICS and IMIS: Review (jointly with the Office of Programme Planning, Budget and Accounts) costs, time frames, and other requirements necessary to integrate the IMIS and OPICS systems in order to eliminate the manual entry of Escrow Account data, thereby increasing data entry accuracy and simplifying the reconciliation process (AF2001/34/1/09)	(as at 15 July 2002) At the suggestion of the Treasurer, a team has been established, including the staff of the Accounts Division, to implement the interface of OPICS and IMIS. Additional programming resources may be required. Status: Closed OIOS comment: Progress to be monitored
Controls in processing investment transactions: Establish and document well-defined IT policies and procedures for the escrow account (AF2001/34/1/10)	(as at 31 March 2002) As indicated in the memo of 15 November 2002, the IT policies and procedures in effect for OPICS apply equally to the UN Iraq Account and therefore Treasury does not see the need for separate IT policies and procedures for this account. Status: Withdrawn
Strengthen supervisory controls in the creation, approval and recording of Escrow Account investment transactions in OPICS to minimize operational risks and segregate functions relating to these activities (AF2001/34/1/11)	(as at 15 November 2001) The Database Administrator has enforced the proper separation of duties by changing access rights of OPICS users to ensure that the same operator cannot input and approve the same transactions. Status: Closed at the time of final report
Staffing Support: Reassess staffing requirements of its IT, L/C payment, and investment units in order to strengthen internal controls and provide adequate segregation of duties, particularly with regard to the reconciliation process, and ensure that workflows are not interrupted, particularly during the absence of the database administrator and other critical staff. (AF2001/34/1/12)	(as at 15 November 2001) Treasury has already identified a qualified candidate to fill the post of Investment Officer. Both Treasury and OIOS agree that additional personnel are required to support IT operations and Treasury is in the process of seeking approval for additional posts. Finally, proper diversification of banking and L/C arrangements means that personnel requirement for the Oil-for-Food unit of Treasury will triple, at a minimum, and additional Investment and Finance Officers will also be required. Status: Closed at the time of final report OIOS comment: Client should provide information regarding the approval of additional posts.
Bank insurance requirements: Review the insurance clause in the agreements with banks relating to the Escrow Account, and if it is determined that this requirement no longer exists, amend the agreement accordingly (AF2001/34/1/13)	(as at 31 March 2002) Treasury has reviewed all the pertinent files and has asked all institutions involved for updated insurance policies. (Copy of insurance policy that was missing from the files during the audit was provided to OIOS) Status: Closed OIOS comment: Client should provide OIOS with copy of correspondence to the institutions.